

CALIFORNIA FRANCHISE TAX BOARD

Internal Procedures Manual
General Tax Audit Manual

20000 GTA PROGRAM PROCEDURES

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Reviewed: November 2004

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20100 GTA BANKRUPTCY PROCEDURES

GTAM 20110	Bar Date
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GTAM 20180	Bankruptcy - Case Review
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If you have questions that cannot be answered from the following procedures, please contact the GTA Bankruptcy Liaison at * * * * *. If you are from the Federal/State Examination Section, please contact the Fed/State Bankruptcy Liaison at * * * * *.

Audits involving taxpayers that have filed for bankruptcy protection need special handling. There are two principal concerns when a taxpayer files a bankruptcy petition:

- Issue all assessments and file all bankruptcy claims before the "Bar Date."
- Protect the taxpayer's rights with regard to the "Automatic Stay."

NOTE: ((* * *)) = Indicates confidential and/or proprietary information that has been deleted.

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20110 Bar Date

Bankruptcy laws require that we file bankruptcy claims before the bar date. The bar date is set by the court as the last day to file claims in a bankruptcy case. Generally, the bar date is 120 days after the filing of the bankruptcy petition, but the period between filing and bar date may vary. If a claim is not filed timely, we may be barred from collecting current taxes and issuing additional assessments for discharged years. For instructions to identify the bar date from a petition, see GTAM 20122, *Petition Date and Other Information*.

For audit purposes, we are most concerned with the bar date, since we consider this the new statute of limitations. It is critical to know the bar date or if one is set. If the bar date is not available in the file, the collections department can get the bar date or find out if a date is set. Consult your lead or the Audit/Bankruptcy Liaison if you need information about the bar date. You may want to call the automatic bankruptcy system. This system gives you any information pertaining to the case, including the bar date and bankruptcy chapter. Before you call, have taxpayer's social security number readily available. Automatic Bankruptcy System Phone Numbers by District:

- Eastern District of California (916) 498-5583/(800) 736-0158
- Central District of California, Santa Ana (714) 836-2278
- Central District of California, San Bernardino (909) 383-5552
- Central District of California, San Fernando Val. (818) 587-2936
- Central District of California, Santa Barbara (805) 899-7755
- Central District of California, Los Angeles (213) 894-4111
- Northern District of California (415) 705-3160/3161
- Southern District of California (619) 557-6521

When you will not complete enough audit development before the bar date, you may need to issue provisional assessments in order to meet it.

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20111 Automatic Stay

When a taxpayer files a bankruptcy petition, it imposes an automatic stay. It is effective *immediately* upon filing. The automatic stay prohibits creditors or potential creditors from making demands upon the petitioner.

The bankruptcy provisions have been revised. The Bankruptcy Reform Act of 1994 (H.R. 5116) is effective for taxpayers whose bankrupt petitions were filed with the Bankruptcy Court on or after October 22, 1994. This law revised the automatic stay provisions of the Bankruptcy Code as it relates to tax assessments. However, we still cannot demand information under the automatic stay provisions.

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20112 Petition Date Before 10/22/94

When the bankruptcy petition is filed *before* 10/22/94, the automatic stay prohibits us from taking a number of actions, including:

- Demand letters;
- Levies;
- Bills;
- Notices of Action, Notices of Revision, or Notices of Determination
- Liens;
- Jeopardy (without permission from the taxpayer); and
- Finalization of Notices of Proposed Assessment.

With the taxpayer's permission, you may continue the following:

- Audit letters;
- Telephone calls; and
- Audit information requests.

You may issue a Notice of Proposed Assessment while the taxpayer is in automatic stay, but *you must flag the Assessment with the bankruptcy code* (it will read *Bankruptcy* on TI) immediately to ensure the Notice will not go final. Contact the Bankruptcy Team to alert them that an audit is in progress, so that they can file a claim before the bar date. Send a copy of the Notice to Mail Stop G-1 Bankruptcy.

When taxpayers tell us that they have filed a bankruptcy petition you may ask them the chapter under which they have filed. You may also request copies of the bankruptcy documents. See GTAM 20120, *The Bankruptcy Unit*, for some definitions of the various types of bankruptcy.

NOTE: Courts have awarded attorney's fees when IRS agents persisted in pursuing audit information after being informed of the bankruptcy petition and after the taxpayer asked to stop information development. See *William Sheldrick, et ux, United States Bankruptcy Court* for the Northern District of New York, 87-01123.

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20113 Petition Date On or After 10/22/94

When the bankruptcy petition is filed *on or after 10/22/94*, the automatic stay prohibits us from taking a number of actions.

With the taxpayer's permission, you may continue the following:

- Audit letters
- Telephone calls
- Audit information requests

With or without the taxpayer's permission, you may issue the following, (H.R. 5116):

- Notices of Action, Notices of Revisions, or Notices of Determination
- Standard Bills

You may issue a Notice of Proposed Assessment while the taxpayer is in automatic stay, and the Notice will also go final after the 60 day protest period has passed. Before releasing the Notice, send a copy to the Bankruptcy Unit at Mail Stop G-11: Bankruptcy.

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20120 The Bankruptcy Unit

The Bankruptcy Unit is in the Special Programs Bureau. They coordinate all bankruptcy actions. The Bankruptcy Unit files claims with the Bankruptcy Court, advises other units on bankruptcy procedures, provides training, and coordinates activities among our employees, the Attorney General's Office, and taxpayers on bankruptcy matters.

The Bankruptcy Unit collects amounts owing from taxpayers that have filed for bankruptcy protection. They are an important source of information and support when you audit a taxpayer seeking bankruptcy protection. To contact the Bankruptcy Unit, call * * * * *. The Audit/Bankruptcy Liaison should call first. If the Audit/Bankruptcy Liaison is not available, your Lead Auditor may contact the Bankruptcy Unit.

Bankruptcy Unit actions vary depending on the type of bankruptcy that the taxpayer files.

- Chapter 7 - Taxpayer liquidates most assets and liabilities. About 85% of the time, taxes are collectible after the bankruptcy is discharged.
- Chapter 11 - Business reorganization. Taxpayer makes payment plan to pay off debt over 6 years. These accounts are followed up by collections for adherence to the bankruptcy plan. Taxes are collectible after the bankruptcy is discharged.
- Chapter 13 - Taxpayer is generally a wage earner with a regular income. A payment plan is set up and monitored by a trustee. Taxes are collectible after the bankruptcy is discharged.

Most of the other types of bankruptcy chapters are seldom used. They are:

- Chapter 9 - For Municipalities. No application for income tax purposes.
- Chapter 12 - Adjustment of debts of a family farmer. There are very few of this type.
- Chapter 20 - Not a true bankruptcy chapter, but a combination of Chapters 7 and 13. It stops interest accrual as of the petition date. Taxpayer first files Chapter 7 to get rid of unsecured creditors, then files Chapter 13 to pay taxes and secured debts.

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20121 Identifying Taxpayers Seeking Bankruptcy Protection

In some cases, a taxpayer or representative will tell you about a bankruptcy petition. In addition, you may know facts about a taxpayer's financial condition that suggest the taxpayer is considering bankruptcy protection. If either situation arises, see GTAM 20140, *Audit Bankruptcy Procedures*, for how to proceed.

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20122 Petition Date and Other Information

By knowing the Bankruptcy Petition number, you can get much information. For example:

- CASE NUMBER 1-90-12345-11

1 = court number

90 = year filed

12345 = petition number

11 = chapter number

- OTHER BANKRUPTCY DEFINITIONS

Dismissal of Bankruptcy - Bankruptcy petition was denied.

Bar Date or B. D. - Final date for filing a claim against the bankrupt estate. For collection purposes, this is the new statute of limitation date to file a claim.

Mailing Matrix - List of creditors supplied by petitioner.

Automatic Stay - Restraining order prohibiting those activities listed in GTAM 20111 (see GTAM 20111, *Automatic Stay*). This includes finalizing assessments if the petition date is before 10/22/94.

If a case has been discharged, dismissed, or closed, you may take any action. Other than Chapter 13, the FTB liability *will not* be discharged by the court if:

1. The taxpayer did not file returns.
2. The due date of the returns is fewer than three years before the petition date.
3. A late return is filed fewer than two years before the petition date.
4. A Notice of Proposed Assessment goes final fewer than 240 days before the petition date.
5. A Notice of Proposed Assessment is in protest or is not final.
6. Fraudulent returns are filed.
7. A Notice of Proposed Assessment is not issued.

If a taxpayer states that taxes were discharged under a bankruptcy, have the Audit/Bankruptcy Liaison call the Bankruptcy Unit for direction. You may want to call the automatic bankruptcy system. This system has information pertaining to the case, including the bar date and bankruptcy chapter. Before calling, have the

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taxpayer's social security number readily available. Automatic Bankruptcy System Phone Numbers by District are:

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- Central District of California, Santa Ana (714) 836-2278
- Central District of California, San Bernardino (909) 383-5552
- Central District of California, San Fernando Val. (818) 587-2936
- Central District of California, Santa Barbara (805) 899-7755
- Central District of California, Los Angeles (213) 894-4111
- Northern District of California (415) 705-3160/3161
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20130 Additional Information and Training

For further information or directions, contact the Bankruptcy Unit. In addition, a four-hour Bankruptcy Training Class is available upon request. The class covers the basics of bankruptcy, including the Automatic Stay, Bankruptcy Chapters, special income tax filing requirements, and the consequences of bankruptcy discharge. To schedule a class, have your Supervisor contact the Training Academy.

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20140 Audit Bankruptcy Procedures

If you receive a case that may be in bankruptcy, check the Taxpayer Information System. You may see a *bankruptcy* indication in the "Taxpayer Status Field" or the "Protest Field." If there is not an indicator in the Taxpayer Status Field or the Protest Field, route the case to the Bankruptcy Unit (see GTAM 20120, *The Bankruptcy Unit*) or the Protest Control Desk, and flag the case with the proper code. Once the flag has been set, note if the petition date is before 10/22/94 (see GTAM 20141, *Procedures when the Petition Date is Before 10/22/94*). If the petition date is on or after 10/22/94, see GTAM 20142, *Procedures when the Petition Date is on or after 10/22/94*.

For cases that have not been assessed, contact the Bankruptcy Liaison (see GTAM 20120, *The Bankruptcy Unit*) to see if the bar date is still open. If the bar date is closed, it may be better not to issue a Notice of Proposed Assessment. However, if the bar date is open, the Bankruptcy Liaison can inform you how much time is left to issue a Notice. For more information on the bar date, see GTAM 20110, *Bar Date*.

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20141 Procedures when the Petition Date is Before 10/22/94

Bankruptcy Correspondence, Non-Final and Protested Notices of Proposed Assessment

- You, the notice's creator, or staff examining the case *holds* the case until the Bankruptcy Flag is removed.
- When the Bankruptcy is pending, you or the notice's creator sends a letter to the taxpayer indicating the following:

Cases in Protest – to tell the taxpayer

- We received the bankruptcy protest.
- Billing is or is not delayed pending the outcome of bankruptcy.
- Bankruptcy is not an issue that can be protested.
- If you, the taxpayer, have reasons other than bankruptcy to protest the Notice, let us know within the specified follow-up period.

Non-Final /Non-Protested Cases

- We received the bankruptcy correspondence.
- Billing is or is not delayed pending the outcome of bankruptcy.
- Other taxpayer concerns following normal unit procedures.
- If billing is not delayed pending bankruptcy outcome, you or technician can resolve all issues other than bankruptcy issue by following normal unit procedures.
- If the billing is delayed pending bankruptcy outcome, you or technician can resolve all issues other than the bankruptcy issue by following the normal unit procedures except:
 - You cannot issue Notices of Action, Notices of Revision, or Notices of Determination.
 - You cannot finalize petition dates before 10/22/94, according to *Schwartz v. U.S., Court of Appeals (9th Cir.), January 22, 1992*. Therefore, you should flag these cases to prevent finalization. To do so, contact the Bankruptcy Unit. They will flag the case pending bankruptcy. Chapter Seven bankruptcies are usually complete within 120 days. Chapter 11 or Chapter 13 may take four or five years to complete.

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- Once all issues other than bankruptcy are resolved, close the case and return it to file using ADF-B procedures (see GTAM 20143, *ADF-B Procedures*). If you need the file later, you or the technician should request the case file from the ADF-B file in General Tax Audit Support, Technical Support.

Bankruptcy Correspondence, Final NPAs

- When correspondence claiming bankruptcy comes after the Notice of Proposed Assessment has gone final, contact the Audit/Bankruptcy Liaison. The Audit/Bankruptcy Liaison will let you know whether to abate the Notice. The GTA Technical Support staff abates the Notice and the audit staff re-issues it if the normal Statute or bar date Statute is not closed.
- If the Bankruptcy Unit gets taxpayer correspondence on a case where the Notice is final and voided by the automatic stay provisions, the Bankruptcy Unit copies the Notice and routes it and the correspondence Notice's maker. If the Notice is based on a Revenue Agent Report, they route the case to the Revenue Agent Report unit/Attn: Bankruptcy Liaison. You or the coordinator have the Technical Support staff abate the Notice. Then you or the technician re-issues the Notice if the normal Statute or bar date Statute is still open.

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20142 Procedures When the Petition Date is On or After 10/22/94

The revised bankruptcy code will allow Notices of Proposed Assessment to go final while the taxpayer is in bankruptcy. Therefore, you do not need to put Notices in protest status if the only protest issue is bankruptcy.

Bankruptcy Correspondence, Non-Final and Protested Notices of Proposed Assessment

1. The notice's maker should resolve all issues besides the bankruptcy issue by following normal unit procedures.
2. You may issue Notices of Action, Notices of Revision, and Notices of Determination at any time. Route a copy of the Notice of Action or Revision to the Bankruptcy Unit to use when the proceedings are complete.
3. Once all issues besides bankruptcy are resolved, close the case and return it to file using ADF-B procedures (see GTAM 20143, *ADF-B Procedures*).

Bankruptcy Correspondence, Final Notices of Proposed Assessment

1. When you receive correspondence claiming bankruptcy after the Notice of Proposed Assessment has gone final, check the Taxpayer Information system for the proper code and alert the Bankruptcy Unit (see GTAM 20120, *The Bankruptcy Unit*). The Bankruptcy Unit will properly code the system to prevent additional billings to Standard Billings from going to the taxpayer until the bankruptcy issue is resolved.
2. If the Bankruptcy Unit receives taxpayer correspondence on a case where the Notice is final and voided by the automatic stay provisions, the bankruptcy team copies the Notice and routes it and the correspondence to the notice's maker. If the Notice is based on a Revenue Agent Report, they will route the case to the Revenue Agent Report unit (Attn: IRS Coordinator). You or the coordinator reviews the correspondence and determines if an adjustment, based upon the technical issue, is necessary. If so, have the Technical Support staff abate the Notice and have a new Notice issued if the normal Statute or bar date Statute is still open.
3. Things to remember:
 - a. If a taxpayer has a bankruptcy petition date on or after 10/22/94, all assessments issued after the bankruptcy petition date may go final, and are subject to the new bankruptcy laws regarding the automatic

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- stay. See GTAM 20113, *Petition Date On or After 10/22/94*.
- b. If a taxpayer has a bankruptcy petition date before 10/22/94, all assessments issued after the bankruptcy petition date may *not* go final and are subject to the old bankruptcy laws regarding the automatic stay, even if the assessment taxable year ends after 10/22/94. See GTAM 20112, *Petition Date Before 10/22/94*.
 - c. We could lose the bankruptcy if we put a bankruptcy case in PF status without assessing tax until the Tax Court decides, or the case is out of bankruptcy. This applies to both pre- and post-petition date cases. If this is the case, issue a protective Notice and contact the Special Procedures Unit at * * * * *.

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20143 ADF-B Procedures

The ADF-B File keeps returns on closed cases where the taxpayer filed for bankruptcy protection. Older year returns, usually requested by the Revenue Agent Report Unit, are available if we get more information from the taxpayer, the IRS, or the Bankruptcy Unit.

Once a case is identified on the Taxpayer Information System as a bankruptcy and all the technical issues are resolved, route the case to the Protest Control Desk. On the route slip, indicate the return should be filed in the ADF-B File. If a Collection File exists, place comments there, indicating which returns were sent to the ADF-File. You may want to place a comment on the Taxpayer Information file as well.

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20150 Prompt Audit Requests

In accordance with Bankruptcy Code Section 505(b), a trustee of a bankruptcy estate can avoid personal liability by requesting a prompt audit of the corporate returns filed under the trustee's administration of the bankruptcy estate. We have 60 days from the date we get the trustee's letter to notify the trustee that we are starting an audit on specified tax years. After 60 days, the Statute of Limitations expires to audit returns for specified tax years filed during bankruptcy proceedings. If we perform a timely examination, we have 180 days from the date we get the request to complete the audit and notify the trustee of any tax due. Otherwise, we lose the Statute of Limitations for assessing tax after 180 days.

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20160 Statute of Limitations

For audit purposes, the Statute of Limitations for assessing tax on a Personal Income Tax taxpayer is the earliest of:

- The Statute of Limitations under the Revenue and Taxation Code (see GTAM 10000, *Statute of Limitations*);
- The bar date under the Bankruptcy Code (see GTAM 20122, *Petition Date and Other Information*); or
- The time limits under the prompt audit request provisions of the Bankruptcy Code (see GTAM 20150, *Prompt Audit Requests*).

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20170 Enterprise-Wide Bankruptcy System

The Enterprise-Wide database includes bankruptcy case information from courts throughout California and other states (when we are notified or have a matching account). It includes information on:

- Individuals
- Corporations
- Partnerships
- Municipalities

Using the System helps prevent violations of bankruptcy laws, maximize claims issuance, and promote compliance. To determine your level of access to the System, contact your supervisor, or have your supervisor contact the Accounts Receivable Collection System Help Desk.

The three Central Office computers with the System are located at:

- Unit 389
- Unit 348
- Unit 343

There is an instruction package next to each computer, and posted Help Desk phone numbers.

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20180 Bankruptcy - Case Review

When reviewing a Bankruptcy case, verify that the taxpayer's account is coded as a bankruptcy account before releasing the notices. Also verify that:

- The notice will not be issued after the BAR DATE,
- No violations were made during the AUTOMATIC STAY, and
- The taxpayer's Taxpayer Information and Business Entities account is properly coded.

If the file is properly coded, the TI and BETS Systems determine if the case goes final, and what bills to issue. The two systems are programmed to identify the petition date. The petition date determines if we can finalize a notice and if we can issue a bill. The Bankruptcy Unit sets and removes all bankruptcy codes.

Know when the taxpayer is in bankruptcy in order to avoid violating the automatic stay! Make sure that you issue all Notices of Proposed Assessment *before the bar date*. If you cannot determine the bar date from the file or from the account, call the Bankruptcy Court.

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20181 Review for PIT Bankruptcy



- Check the Taxpayer Information system for comments related to the bankruptcy. Look for notification made to the Bankruptcy Unit of the pending Notice of Proposed Assessment. This may indicate the type of bankruptcy, what the collection unit has done, who the trustee is, a phone number, and the bankruptcy file number. It may even tell you who has worked this case in the past and if the bankruptcy has been discharged or dismissed.
- Check the Taxpayer Information system for the bankruptcy flag. If the taxpayer is flagged for bankruptcy, the flag is located in the upper right corner of the screen under Taxpayer Status and in the middle of the top line of all later screens.
- Check the Enterprise-Wide Bankruptcy System for information on the petition date and claim date. The petition date lets us know what procedures the audit staff follows. The claim date is the date the Bankruptcy Unit filed the claim. We can amend the claim only while the estate is open.
- If the case is officially in bankruptcy and the Taxpayer Information system does not have the flag, notify the Bankruptcy Unit immediately.
- If the assessment is due to a prompt audit, verify the prompt audit statute of limitations. For an explanation of a "*Prompt Audit*," see GTAM 20150, *Prompt Audit Requests*.
- If the taxpayer previously had a bankruptcy flag, and now the flag is gone, you may issue a notice. Check the Collection File for possible comments.
- Update the Event Log to record all review actions taken.

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20200 C CORPORATION PROGRAM

GTAM 20210	Tax Clearance Certificate
GTAM 20220	Post Dissolution
GTAM 20221	Reduced Minimum Franchise Tax Provisions
GTAM 20230	Transferee Liability - Corporation
GTAM 20240	Deductible Dividends

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20210 Tax Clearance Certificate

When a domestic corporation or foreign corporation wants to cease being a going concern in California, they must file for a Tax Clearance Certificate (TCC) by completing the Form FTB 3555. A corporate officer, attorney, or accountant may sign this request. Taxpayers should send requests to the California Secretary of State (SOS). After accepting all SOS and FTB forms, the SOS will establish a conditional dissolution date and forward to FTB the required FTB forms.

Within 30 days of receiving a certificate request, the Franchise Tax Board will either:

- Issue the certificate, or
- Notify the person requesting the certificate of the amount of tax that must be paid; or the amount of bond, deposit, or other security that must be furnished in order to get the certificate.

Before we can issue a Tax Clearance Certificate, a taxpayer must have filed all returns due and paid all liability of record, or have paid all liability that has accrued even though not yet due, including Notices of Proposed Assessment outstanding or in process.

When the taxpayer requests a TCC, they must indicate on the form if they are dissolving with:

- An assumer
- A cash bond, or
- On a Taxes Paid Basis

Assumer:

An assumer is a person or entity that agrees to take on the responsibilities of the outgoing corporation. This means that the assumer has accepted responsibility for tax liability after the dissolution of the corporation.

An audit may be conducted on the corporation, in care of the assumer, even if the tax clearance certificate has been issued. If a liability is assessed on a corporation who has a valid assumer, the assessment should be addressed as:

Corporation Name, Taxpayer

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Assumers Name, Assumer
Address

For example,
XYZ Corporation, Taxpayer
Mr. Smith, Assumer

Cash Bond:

Filing for a Tax Clearance Certificate with a Cash Bond means that the corporation will post a bond, which will be available to pay any additional taxes due. The Tax Clearance Unit will take the necessary steps to ensure the appropriateness of the bond and this should not impact Audit.

Taxes Paid Basis:

A "taxes paid basis" basically means that the corporation has been accepted as qualified to dissolve by the SOS, filed all required returns, and paid all necessary taxes. The corporation will generally completely dissolve, not retain any assets, and there will be no assets on which the FTB may collect.

Note: Corporations that are not qualified or incorporated through the SOS are not required to dissolve or surrender. However, these corporations are required to do the following:

- File a final return
- Check the final return box on side 1 of the return
- Attach a statement saying that they are no longer doing business in California

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20215 Taxes Paid Referrals

After the Tax Clearance Unit receives the FTB Form 3555 filed on a taxes paid basis, they will pull the folder from DSSS and forward it to the Post Dissolution Audit Lead for review, who will review each case for audit issues. If there are audit issues, the folder will be forwarded to Audit for additional review.

If no audit is conducted, Audit should return the folder to the Post Dissolution Unit at MS D-7. The PASS case unit should be referred to the personal inventory of the Post Dissolution Unit Lead Auditor. * * * * *

If an audit is conducted, notify the Post Dissolution Unit Lead Auditor by e-mail. Include the name of the corporation and California Corporation Number.

In addition, in the initial audit letter, the taxpayer should be informed that a tax clearance certificate will not be issued until the audit is completed and that all liabilities must be paid in full prior to receiving a tax clearance certificate. The following paragraph may be used in audit letters to explain:

"You have applied for a Tax Clearance on a Taxes Paid basis. A Tax Clearance Certificate cannot be issued until the completion of this audit. If an assessment is made as a result of the audit, a Tax Clearance Certificate will be issued after full payment of all tax, penalties, and interest."

At the end of the audit, if a no change or no audit letter is sent, return the corporate folder to the Post Dissolution Unit.

If there is an adjustment, notify the taxpayer that they will have to reapply for the tax clearance certificate after the case has been processed and any outstanding tax liability is fully paid.

You do not need to sign the corp folder like you do with other Post Dissolution referrals.

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20220 Post Dissolution

A domestic corporation or a qualified foreign corporation dissolves or withdraws through the Office of the Secretary of State. After dissolution or withdrawal, the Post Dissolution Unit (PD) will review the corporation folder for all outgoing entities. To do so, they will review the corporations' tax returns to determine the correct tax liability for each year and verify that all income is properly reported. Returns may be referred to the audit staff for additional review or audit, if warranted.

If a return is referred to Audit, PD will stamp, sign, and date the corporation folder. This allows Audit to return the case to files without requiring any further action.

If there is a dissolution date and two initials on an outgoing corporation's folder, the folder is complete and ready to destruct by our storage facility, following normal destruct rules. If there are only one or no initials, the folder will be referred back to PD. Our Storage unit will not dispose of a folder that is not dated and signed with two initials.

The auditor will audit the return following normal audit procedures. Audits and dispositions of Post Dissolution audits do not require special handling.

However, please note that a "Taxes Paid" case referred from Post Dissolution does require special handling. See GTAM Sec. 20210 for more information.

Reviewed: November 2004

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20221 Reduced Minimum Franchise Tax Provisions

The prepayment to the Secretary of State is a payment toward the tax for the first taxable year. Because there is no preceding taxable year, the tax liability is the minimum franchise tax. For taxable years beginning *on or after January 1, 1997 and before January 1, 1999*, the amount payable by a Qualified New Corporation to the Secretary of State is \$600. For taxable years beginning *on or after January 1, 1999*, the amount payable by a Qualified New Corporation to the Secretary of State is \$300.

If a taxpayer pays the reduced minimum tax to the Secretary of State but later determines that it was *not qualified* for the reduced amount, it owes an additional amount with the tax return for the first taxable year. The first year tax return determines the tax for the second taxable year.

- Example: For years beginning on or after January 1, 1997, and before January 1, 1999, the beginning corporation has to pay \$200 (\$600 + \$200). For years beginning on or after January 1, 1999, the beginning corporation has to pay \$500 (\$300+ \$500).

If a corporation paid \$800 to the Secretary of State but was a Qualified New Corporation, the overpayment is reflected on the return for the first taxable year.

- Example: For years beginning on or after January 1, 1997, and before January 1, 1999, the beginning corporation's overpayment is \$200 (\$800 - \$600). For years beginning on or after January 1, 1999, the beginning corporation's overpayment is \$500 (\$800- \$300).

A Qualified New Corporation must have gross receipts of one million dollars or less and tax liability no more than \$800 on the return for the first taxable year. The first taxable year's return determines the tax for the second taxable year.

For taxable years beginning *on or after January 1, 1999*, if the first taxable year is not the final taxable year, then the prepayment Secretary of State tax is:

- \$300 if it is a Qualified New Corporations; or
- \$800 if it is not a Qualified New Corporation.

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If the corporation thought it was going to qualify but did not, then it prepaid \$300 to the Secretary of State and paid \$500 more with the return for the first taxable year.

For taxable years beginning on or after January 1, 1997 and before January 1, 1999, if the first taxable year is not the final taxable year, then the prepayment for the Secretary of State tax is:

- \$600 if it is a Qualified New Corporation; or
- \$800 if it is not a Qualified New Corporation.

If the corporation thought it was going to qualify but did not, then it prepaid \$600 to the Secretary of State, and paid \$200 more with the return for the first taxable year.

The tax is a measured tax for the first taxable year only if the corporation dissolves during its first taxable year.

If the first taxable year is also the final taxable year, then the tax liability is the measured tax, but not less than:

- The reduced minimum tax if it is a Qualified New Corporation (\$600 for years beginning on or after January 1, 1997 and before January 1, 1999, and \$300 for years beginning on or after January 1, 1999); or
- \$800 if it is not a Qualified New Corporation.

For taxable year beginning on or after January 1, 1999, for the second taxable year, the tax liability is the measured tax, but not less than:

- Reduced minimum tax (\$500) if it is a Qualified New Corporation; or
- \$800 if it is not a Qualified New Corporation.

For taxable year beginning on or after January 1, 1997 and before January 1, 1999, for the second taxable year, the tax liability is the measured tax, but not less than:

- Regular Minimum Tax (\$800) whether or not a Qualified New Corporation.

The franchise tax is imposed under CR&TC Section 23151, and the amount of tax is measured by income, unless the minimum franchise tax defined in CR&TC

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section 23153 is greater. Thus, a measured tax that is greater than the minimum tax always supersedes the minimum tax.

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20230 Transferee Liability - Corporation

If a corporation may be insolvent, whether or not it has dissolved, consider any transferee liability. Try to gather and include information in the audit file to determine if a transferee liability exists, including:

- The transfer of assets to a transferee, and whether this transfer left the corporation insolvent.
- Whether the transferor corporation is liable for any proposed assessments.
- Whether when the transfer was made a liability accrued, though it wasn't assessed.

If a transferee liability exists, we issue all assessments jointly to the transferor and transferees. Each transferee is liable for the whole assessment. An individual or a corporation may be a transferee.

Reviewed: April 2003

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20240 Deductible Dividends

Before 1990, dividends received from corporations subject to the Franchise Tax or Corporation Income Tax were deductible to the extent paid from earnings previously taxed under the Bank and Corporation Tax Law. The provision aims to avoid double taxation of corporation income.

For taxable years beginning on or after January 1, 1990, CR&TC section 24402 was revised to allow a deduction for the following portion of dividends paid from previously taxed earnings:

- One Hundred percent (100%) if from a more than fifty percent (50%) owned corporation.
- Eighty percent (80%) if from a corporation owned at least twenty percent (20%), but not more than fifty percent (50%).
- Seventy percent (70%) if from a corporation owned less than twenty percent (20%).

Compare the deductible percentages the taxpayer uses to those in the Deductible Dividends Report (<http://www.ftb.ca.gov/msa/ddise.asp>). If information for a particular dividend payor is not in the report, call the Deductible Dividend Desk in Sacramento at (916) 845-4138 for the deductible percentage.

NOTE: The deductible percentages in the report represent 100% of the portion of the dividends paid from previously taxed income. For taxable years beginning on or after January 1, 1990, make an additional adjustment of 70% or 80% if the payor corporation is not more than 50% owned. For example, if the taxpayer receives a dividend of \$100,000 in 1991 from a corporation, and the taxpayer's ownership percentage in the corporation is five percent (5%), calculate the deductible dividend as follows:

Total dividend received	\$100,000
X Deductible percentage from book	<u>3.500%</u>
Portion of dividend declared from previously taxed income:	3,500
X 70% adjustment	<u>70%</u>
Deduction allowed under §24402	<u>\$2,450</u>

Reviewed: April 2003

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20300 ESTATES AND TRUSTS

GTAM 20310.1	Audit Referrals
GTAM 20310.2	Estate Income Tax Certificates
GTAM 20310.3	Short Statute Requests
GTAM 20310.4	Request for Copies of Estates and Trusts Returns - Disclosure
GTAM 20310.5	Assessment of Penalties on Decedent's Individual Returns

Reviewed: April 2003

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20310.1 Audit Referrals

The Estates and Trust unit provides technical support for the following flow-through items distributed from an estate or trust that are reported on an individual Form 540 return:

1. Credits
2. Net Operating Losses
3. Capital Losses
4. Administrative Expenses
5. Bankruptcy Estate Tax Attributes
6. Deductions for:
 - a. Income In Respect Of A Decedent
 - b. Federal Estate Tax
 - c. California Estate Tax (Pick-Up Tax)

Reviewed: April 2003

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20310.2 Estate Income Tax Certificates

Overview

For certain estates, the California Superior Court, Probate Division cannot allow the estate to close unless we certify to the Court for *both* the decedent and the decedent's estate that:

- All taxes that *are due* are paid, and
- All taxes that *may become due* are secured by payment of a deposit.

CR&TC section 19513 requires the fiduciary to get a certificate from the Department if:

- The total value of the assets of an estate exceeds \$400,000, and
- Assets having a total value of \$100,000 or more can be distributed to one or more nonresident beneficiaries.

Purpose Of Certification

The certification requirement prevents assets under the control of the Probate Court of California from being distributed out of state without our authorization.

The certificate notifies the Superior Court, not the fiduciary. The certificate allows the court to accept the "*final account*" of the fiduciary by indicating that, as of the date that we issue the certificate, we are not aware of any unpaid tax, and that any identified potential liability has been secured. Therefore, the tax certificate (1) does not relieve the estate of liability for any taxes due or which may become due for the decedent or the estate, and (2) the certificate does not relieve the fiduciary of the personal liability for taxes and other expenses as imposed by CR&TC section 19516.

Request For Certification

Fiduciaries routinely request a certificate when they request a final hearing date from the probate court. The court hearing is usually scheduled within a few weeks of the fiduciary's petition to close the estate.

CR&TC section 19514 mandates that we have 30 days from the date of the request either to:

1. Issue the certificate, or

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2. Notify the requester of the amount of payment or deposit required to get the certificate.

The *Request For Estate Income Tax Certificate* - Form FTB 3571 must be completed by the fiduciary or the fiduciary's representative and mailed to us. They can get the form from the California Package X Tax Forms Catalogue or by writing to:

California Franchise Tax Board
Tax Certificate Unit,
P.O. Box 1468
Sacramento, CA 95812-1468.

Also, they can request the form by calling (916) 845-4210. They cannot get certification from any of our district offices.

Conditions Required For Certification

When they get a request, the Estates and Trusts Unit examines the decedent's individual and estate Taxpayer Information Systems accounts and income tax returns. If applicable, the fiduciary must provide:

- Payment of any tax that is currently due,
- Deposits to secure payment of non-billable (protested or non-final) liabilities,
- Deposits to secure potential assessments resulting from issues identified upon examination of the individual and individual returns previously filed, and/or
- A return for all taxable years that have ended even if the return is not yet due, or a cash deposit to secure filing of the return.

Request for Payment Not Yet Due

The last requirement exists because a tax liability accrues at the close of the accounting period during which it was incurred, even though the payment is not due until the due date of the return. We cannot certify to the Probate Court that all taxes have been paid or secured without examining the return.

Determination of Deposit Required To Secure Returns Not Yet Due

If the fiduciary is unable to file the return before a scheduled court date, the fiduciary may elect to pay a security deposit to receive certification. The fundamental audit criterion suggests a security deposit of one and one-half the amount of the last full year's tax liability or \$1,000, whichever is greater.

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However, we may modify this amount to reflect negation of non-recurring income reported on the prior year return. We do not consider gains generated from the sale of the estate's primary assets or lump sum retirement fund distributions when determining the amount of security deposit.

Fiduciaries must provide certification even if they have an extension to file a return. However, we will include estimated tax payments/and or remittance made with an *Automatic Extension for Fiduciaries* - Form FTB 3563, as part of a cash deposit requested.

Reviewed: April 2003

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20310.3 Short Statute Requests

CR&TC section 19517 provides that a fiduciary or other person liable for the tax may request, in writing, to shorten the period for mailing notices proposing to assess tax, to 18 months on all income received or accrued during the decedent's lifetime or by his estate or trust during the administration period.

To be valid, the request must:

- Be transmitted separately from any other document,
- Indicate clearly that it is a request for prompt assessment under the provisions of CR&TC section 19517,
- Indicate the kind of income tax, the name and the account number shown on the previously filed California income tax return, and
- Specify the taxable periods for which the prompt assessment is requested.

We do not have a form comparable to the IRS Form 4810. However, we will accept the federal form if it is completed to reflect the above requisites.

NOTE:

- A request under CR&TC section 19517 does not extend the statute.
- Filing an amended return will negate all prior requests for that taxable year.
- Section 19517 does not limit the assessment period on a "*Married Filing Joint*" return because of the survivor's joint and several liabilities.

The Estates and Trusts Unit enters a comment on the Taxpayer Information Comment Input Screen indicating that a short statute has been granted. Check the Comments Screen to see if the statute is still open before using audit resources on a case.

Processing and Recording Requests

The technician processes the requests for a short statute as follows:

- Update address and code the account "*DECEASED*."
- Verify that the return is filed for years subject to the short statute request. Inform the fiduciary if we have no record of a return filed.
- Reverse discharged liabilities.
- Provide a copy of the request to collections if the account is assigned.

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- Input information on the Taxpayer Information Comment Screen indicating the Statute date.
- Acknowledge receipt of the short statute request to the fiduciary.

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20310.4 Request for Copies of Estates and Trusts Returns - Disclosure

Returns

You may furnish copies of the decedent's individual and estate returns to the fiduciary or the attorney for the fiduciary or to the surviving spouse, if the surviving spouse signed the returns. All such requests are routed to the Data Services and Storage Section, RID unit, Mail Stop C-2. We charge taxpayers for copies of the returns if an issue we opened did not cause the request.

Disclosure - Estates

The Security & Disclosure procedures provide that disclosure of information from the return of an estate is authorized to:

- The administrator, executor or trustee of the estate and to any beneficiary in those years he/she received a distribution from the estate.
- The duly constituted attorney-in-fact of any of the foregoing persons, subject to the conditions of inspection prescribed for such person.

Disclosure - Trusts

The Security & Disclosure procedures provide in part that disclosure of information from the return of a trust is authorized to:

- The trustee or trustees, jointly or severally.
- Any person who was a beneficiary of the trust during any part of the period covered by the return, upon submission of satisfactory evidence that the person was such a beneficiary.

Reviewed: April 2003

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20310.5 **Assessment of Penalties on Decedent's Individual Returns**

Penalties applicable to a living individual's personal income tax return are applicable to the individual returns of a deceased taxpayer.

Delinquent Penalty

- Returns due, but not filed by the decedent before date of death.

Unless due to reasonable cause, the delinquent penalty imposed by CR&TC section 19131 is assessed in accordance with the length of the delinquency at the time of death.

Example: Assume the taxpayer (1) died June 20, 19X3, without filing 19X1 and 19X2 calendar year returns, and (2) the fiduciary or the decedent's estate filed the returns subsequent to date of death. The length of the delinquency would be computed from the due date of the returns to the date of death.

- Returns for the year in which taxpayer died.

Returns for the year of death must be filed by the fiduciary of the taxpayer's estate. The return is due three months and 15 days after the close of the taxable year, the taxable year being the normal 12-month period beginning with the first day of the decedent's taxable year.

The fiduciary, if one is appointed, or beneficiary must file the return. The surviving spouse may file a joint return if (1) no fiduciary is appointed, or (2) if the appointed fiduciary does not file a "*Single*" return for the decedent, and if (3) the surviving spouse did not remarry during the taxable year. Unless there is reasonable cause, the penalty for failure to file a timely return is assessed.

Other Penalties

All other remedial and compensatory penalties applicable to a living individual's return may be assessed in connection with adjustments to a decedent's return.

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20400 CREDITS

GTAM 20410	California Economic Development Areas Manual
GTAM 20420	Manufacturers' Investment Credit
GTAM 20430	Research & Development (R&D) Credit

Reviewed: April 2003

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20410 California Economic Development Areas Manual

See the California Economic Development Areas Manual.

Reviewed: April 2003

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20420 Manufacturers' Investment Credit

The Manufacturers' Investment Credit is addressed in CR&TC section 17053.49 & CR&TC section 23649. More information on the Credit is available on the FTB website at

<http://www.ftb.ca.gov/geninfo/credits/mic/references/index.html>

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20430 Research & Development (R&D) Credit

The Research & Development Credit is addressed in CR&TC Section 17052.12 and CR&TC section 23609. * * * * *

NOTE: ((* *)) = Indicates confidential and/or proprietary information that has been deleted.

Reviewed: April 2003

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